

Tax Reform Study Committee

October 14, 2003
MACo Conference Room
2715 Skyview Drive, Helena, Montana

MINUTES

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file at the **Department of Revenue**. Exhibits for this meeting are available upon request.

COMMITTEE MEMBERS PRESENT

Ken Morrison
Myles Watts
Mary Whittinghill
Rep. Eileen Carney
Rep. Jill Cohenour
Rep. Bob Lake
Rep. Jim Peterson
Sen. Gary Perry
Sen. Keith Bales
Sen. Dan Harrington
Sen. Gary Perry

COMMITTEE MEMBERS EXCUSED

Sen. Jon Ellingson
Jerry Driscoll

STAFF PRESENT

Larry Finch, Department of Revenue
Dan Dodds, Department of Revenue
Linda Francis, Director, Department of Revenue
Jackie Williams, Department of Revenue
Prudence Gildroy, Secretary

AGENDA & VISITORS

Agenda (ATTACHMENT #1)
Visitor's list (ATTACHMENT #2)

COMMITTEE ACTION

Public Testimony

CALL TO ORDER AND ROLL CALL

The meeting was called to order by **Senator Keith Bales, Chairman**, at 8:30 a.m. Secretary noted the roll.

The minutes of the previous meeting were approved.

Sen. Bales stated the purpose of the committee was to study the current tax system, look at the different sources and any taxing system alternatives. They are to identify the impact taxes have on individuals and businesses. A letter was sent out to various groups and individuals and a press release was sent to the newspapers asking for public comment. Four questions were asked:

- How do you view the state's current tax system?
- What changes would you recommend to Montana's tax system?
- If your recommendations result in more or less revenue, where would you increase or decrease state or local government spending?
- What is the public's acceptability of what you might be proposing?

Sen. Bales indicated they were looking for solutions. The committee will evaluate the current system and come up with proposals for the 2005 legislature.

PUBLIC COMMENT ON TAX REFORM IN MONTANA

Alan Tomkins, retired systems analyst, read from a letter he prepared for the committee. He was a systems analyst in both state and private industry and was interested in Montana's personal income tax system for a number of years. Over a year ago, he contacted the Department of Revenue to discuss an idea on how the system could be more efficient. A description of his idea was attached to the letter. He observed the income tax system was used to subsidize the property tax system to provide property tax relief. This places an unnecessary and unfair burden on income taxes. The income tax is based on what an individual earns while the property tax is based on the goods that are purchased. He thought property tax relief should be based on the need to adjust property taxes as a whole. By the same reasoning the income tax system should not be used to subsidize the property tax system. It should reflect the true characteristics of income requirements to live in Montana. Governor Judy Martz stated on several occasions that Montana is 46th in the nation in personal income and he suggested the income tax system be redesigned using U.S. Department of Health and Human Services poverty guidelines. These guidelines would provide for all Montanans to meet their household needs on an equal basis. His written information included an overview and ideas on the personal income tax system, an illustration of how the income is distributed, and a description of property taxes.

Questions from the Committee:

Rep. Bob Lake asked **Mr. Tompkins** to elaborate on using the poverty guidelines as a base. **Mr. Tompkins** indicated the **Department of Public Health and Human Services** establishes the poverty level guidelines for food stamps and other benefits. This tells

what a family or household needs to maintain. **Rep. Lake** asked him to elaborate on how he would use that criteria and whether or not he would be using the poverty level or a percentage above the poverty level as the base for where the income tax starts. **Mr. Tomkins** affirmed it would be used as the base. In addition, some retirement income would be non-taxable. If the poverty level income is subtracted from that income, the difference would not be taxed. Contributions to educational savings accounts and all medical expenses would be deductible. **Rep. Lake** asked how that is different than the current system. **Mr. Tomkins** replied the basic difference is removing the property tax from the deductions. The property tax deduction changes the income tax percentage so it has to cover what is not being paid.

Mike Scholz, President of the **Montana Innkeepers Association** and member of the **Tourism Advisory Council**, advised he was there representing the Council. He expressed their primary concern pertains to the funds collected from the bed tax and their expenditure. Tourism is a bright spot in Montana's economy and also that of the whole Rocky Mountain region. The dramatic effect tourism can have in the region is being recognized and acted upon by neighboring states. The importance of tourism is drawing economic development. Nationwide, after the tragedies of 9/11, when travel in this country came to a standstill, it became evident to cities and small towns alike how important tourism was to local economies and the tax base. Many of these governments, including Wyoming and Colorado, have gone to their general funds in these tough budget times to increase spending on tourism promotion to grow their economies. State economies need to grow if needed services are not to be cut. Tourism plays a major role in Montana's economy. Non-resident expenditures have a combined direct and indirect economic impact of \$2.6 billion, contribute 41,900 jobs and are attributable to \$130 million in state and local taxes—nearly 20% of the state and local taxes collected in Montana. Montana's tourism industry can do more for the state's economy and better fund government if the legislature will work with the tourism industry, he contended. The bed tax is at 7% and the legislature needs to stop looking at these funds as an additional source of easy money that will only temporarily make their problems go away. Growing the economy is the best long-term solution, according to **Mr. Scholz**. More promotional dollars for **Travel Montana** would mean a stronger economy for Montana and more tax dollars for services for all Montanans. There is a revitalization of many downtown centers whenever big box stores threaten their existence. This revitalization could be seen from Lewistown to Livingston, Bozeman to Kalispell, big towns and small towns alike. It is tourism that makes these galleries, boutiques and eateries possible. Tourism reaches way beyond the traditional industries of retail sales, gasoline, lodging, restaurants and groceries. The construction industry is booming in Montana and not just in communities like Big Sky. In Glasgow, they completed a \$6 million federally funded museum and are breaking ground for a \$20 million fish hatchery. Tourism helps make these projects possible. Promotion is a key to driving the economy in the future. That is why Colorado just added \$9 million to their advertising budget. In Montana, the percentage of bed tax used for advertising purposes has dwindled over the last ten years to help build the tourism industry infrastructure throughout the state. These were needed projects, but now he felt they need to concentrate on growing the economy through promotion. **The Tourism Advisory Committee** wanted to see the **Tax Reform Study**

Committee recommend an increase in the funding of **Travel Montana** for promotional purposes. This could be funded with the 3% increase in the bed tax enacted in the last legislative session. **The Tourism Advisory Council** endorses a balanced tax system that incorporates not only income and property taxes but a broad based sales tax. A balanced approach will offer both needed tax relief where the system has become non-competitive with neighboring states and the ability to tax non-residents who visit the state. They endorsed the governor's proposed tax reform plan in the last session in its initial form. It taxed nine different types of businesses whose merchandise and services were purchased by both residents and non-residents. Their preference is to have even a broader sales tax than the governor's initial proposal that would at least include the retail industry.

Questions from the Committee:

Mary Whittinghill asked **Mr. Scholz** to provide the figures to the committee.

Sen. Dan Harrington asked if they were to enact a sales tax, if **Mr. Scholz** thought it should be added to the bed tax or if that tax should be lowered. **Mr. Scholz** advised the original four percent bed tax would stay in place. The three percent that was enacted in the last session was really on two industries. If a sales tax is added, it would be added to the four percent and not the seven.

Rep. Bob Peterson asked if they were to implement a broad based sales tax, if **Mr. Scholz** thought the legislature should just do it or if it should be put before a vote of the people. **Mr. Scholz** preferred the elected officials implement it. **The Tourism Council** does not take a position on that issue.

Rep. Lake asked if a four percent sales tax added to the four percent bed tax would still keep Montana reasonably competitive with surrounding states. **Mr. Scholz** indicated nationally the average bed tax is above eight percent, and over half of the bed tax is always a general sales tax. In Big Sky, they also have a resort tax and ten percent would raise some eyebrows. People notice ten percent on their bill but it is not something that doesn't happen somewhere else. As an innkeeper, he felt that was not too bad a burden, but didn't think that burden should only be placed on the innkeepers. He favored a partial bed tax and a general sales tax or a broad based selective sales tax. He repeated the innkeepers supported the governor's tax plan as it first came out. He stressed that tourism can help grow the economy. In Colorado, one dollar of promotion brought \$216 in new revenue into the state and \$12.50 in tax revenues.

Ms. Whittinghill asked about the resort tax if the state adopts a four percent sales tax and local option taxes. **Mr. Scholz** advised the committee has to assess the need and look at who is paying the taxes. He felt the local option tax should be left up to local governments.

Mr. Miles Watts asked **Mr. Scholz** to suggest what a broad based sales tax might be used for. **Mr. Scholz** advised a balanced approach is needed when it comes to tax reform. He preferred to grow the economy as opposed to just increasing taxes. His industry can help

grow the economy with relatively little money. He didn't know what other industry could spend \$5 to \$10 million and drive demand. In tourism, they have proven it can be done.

Sen. Harrington asked **Mr. Scholz** about his feeling about taxing services as part of a broad based sales tax. **Mr. Scholz** advocated broadening the tax base and replied he hoped the income tax and property tax would be adjusted. Non-residents would be also be paying. **Sen. Harrington** asked if it was called a broad based tax if it would have to include services. *(Tape 1, Side B)* **Mr. Scholz** thought a broad based sales tax should include services and felt all industries should contribute. The real estate transaction tax should help and should be looked at.

Sen. Bales asked about **Mr. Scholz's** comment that he favored a broad based sales tax and dropping the three percent in favor of the four percent general sales tax. **Mr. Scholz** indicated they are funding promotion out of the bed tax. Most states use the general fund for economic development. The three percent is used in the next three years to reduce the deficit and he felt it could better be used for growing the economy and creating a tax base. It seemed inequitable to have two industries, the rental car industry and the lodging industry, taking care of the deficit as opposed to having a broad based tax. **Sen. Bales** asked with a four percent bed tax and a four percent general sales tax if he thought seven percent of that should go to promotion. **Mr. Scholz** thought that would be a good decision. The four percent is already going there. Competitiveness is an issue. Tourism can help raise revenues to help the deficit.

Rep. Lake asked how much is going to promotion. **Mr. Scholz** indicated \$2.6 million is directed at advertising. The four percent bed tax is bringing in about \$12.4 million. **Rep. Lake** asked about the total revenue used for promotion. **Mr. Scholz** advocated anything above the four percent be used strictly for promotion. He indicated any added funding for **Travel Montana** should go for promotion. Promotion is different than the Internet, and call centers are not part of the advertising budget. Upon further questioning by **Rep. Lake**, **Mr. Scholz** expressed hope that increased travel promotion funding would come from the general fund like other states to increase economic development. He hoped they would fund the tourist sector because other states have proven that investment will bring back a return. He felt it was one of the best returns for growing the economy.

Stuart Doggett, Montana Innkeepers Association, concurred with many of **Mr. Scholz's** statements on behalf of the Association. As to the view of the Association of the current state and local tax system, he indicated their state convention won't be held until November so he couldn't take an official position until it is reviewed. The previous year, they presented a statement before the legislative session on the Governor's Tax Reform bill. Members were disappointed in SB 407. They initially supported the bill as it was comprehensive and included not only lodging but up to nine other industries that were beneficiaries of the tourism industry in the state. They were disappointed when it was limited to accommodations, rental cars and cigarettes. Members are still optimistic, they want to be progressive and be part of a long-term solution. After their convention last year the innkeepers supported the governor's proposed tax plan to lower the capital

gains tax and personal income tax by using revenue generated from a selective sales tax. They offered support with the stipulation that the accommodation tax currently allocated to tourism promotion be protected and further requested that the promotional budget be increased to help economic development in the state. As to what changes they would recommend to Montana's current tax system and why—they suggested it be broader based. If more revenue is to be collected from tourism it should be broader based than just rental cars and accommodations. A topic that would be discussed at their convention would be speeding up tax reform. The capital gains tax and income tax reduction will not be available to Montanans until 2006. For the next few years, that money will be used to enhance the general fund. As to how they would recommend Montana's current tax system be changed—in the last few sessions they supported a local option tax. It would be capped at 3% and if adopted it would be similar to the existing resort tax. It would be broad based and the same tax rate would be applied to all industries included in a local option tax proposal. As to recommendations resulting in more or less revenue and where they would increase or decrease state and/or local government expenditures, they would like to see additional revenue go towards promoting the state. The return on investment is tremendous, and tourism works. It grows the economy and is a benefit to our state. With more promotional money, more jobs can be created and more revenue generated. As to how receptive they think Montanans are to their ideas for tax reform—they think their members are receptive to working with the committee, the legislature and future administrations towards a broad based selective sales tax with the tourism industry as a part of it. They think Montanans are receptive to looking at tax reform. They hear comments from members about property tax reform, but their first priority is more revenue for tourism promotion.

Questions from the Committee:

Rep. Jill Cohenour advised one of the problems in the last session with the discussions on the local option tax was the way locals could benefit and how it would be distributed. She asked **Mr. Doggett** for his ideas. **Mr. Doggett** replied their position was for a cap of three percent and for the tax to be exclusive to those communities. They didn't delve into how it would be divided up in a statewide pool. Their support was for local areas, because they had seen it work for members. Members in Whitefish who were suspect about the local option tax for a resort community now think it has been a tremendous boost to their communities and economies and have seen how well it's worked. That is the type of option that should be available. **Rep. Cohenour** asked if it the revenue should just stay in that community. **Mr. Doggett** indicated generally yes.

Rep. Lake asked **Mr. Doggett** where personal property taxes and real property taxes should be directed. **Mr. Doggett** indicated his focus is on tourism promotion and he would have to canvas members. **Rep. Lake** asked if he had any idea how much of the current property tax innkeepers are paying falls into personal property and how much into real property. **Mr. Doggett** advised he could get that information. The tourism industry overall generates about 20% of the tax revenue to the state.

Rep. Peterson recalled the legislature struggled with this issue and the industry took a leadership position. They ended up getting singled out as one of three. He asked **Mr. Doggett** for his comments on how a sales tax might be implemented. **Mr. Doggett** favored it be implemented by the legislature with a vote of the people after implementation. The tax would first be given a chance to see how it generates revenue and reduces other taxes.

Rep. Lake asked **Mr. Doggett** for a “dream world” taxing system for his industry. **Mr. Doggett** said if he surveyed the members it would probably be a broad based sales tax with a higher amount of the revenue collected from the bed tax going back towards promotion and lower property tax rates for hotels and motels. They would not want to see the accommodations tax diverted to fund other things outside of tourism promotion. The industry has been accused of being protectionist, but they came forward in 1987 supporting collecting more tax. They wanted it to go specifically for tourism promotion. They are proud of what the accommodations tax has done to generate dollars and jobs in the state.

Sen. Harrington asked, if a sales tax is passed, if **Mr. Doggett** felt it should be new revenue to be used for education, health care, etc., or if a sales tax should be passed under a system of reductions of income and property tax. **Mr. Doggett** advised they supported the offset going into the 2003 session. Some new revenue should go towards promotion. He would bring that up to the members at the convention to get input on how to allocate the revenue.

Betsy Baumgart, Administrator, Department of Commerce, Travel Montana Program, offered Travel Montana’s assistance to the committee as they go through this process. They work closely with the **Institute for Tourism and Recreation Research** and also have access to national statistics through their membership with the **Travel Industry Association**. They could provide information on non-resident travel.

Charles Brooks, Billings, appeared representing himself and **Tom McGillvray** of Billings. He presented copies of **Mr. McGillvray’s** presentation to the committee. (*Exhibit 1*) (*Tape 2, Side 1*) He summarized the points made by **Mr. McGillvray**. A good tax system can build up a state and a bad tax system can destroy it. He listed seven principals:

- A good tax respects privacy, property and freedom
- A good tax does not punish what it creates
- A good tax is simple
- A good tax is by consent
- A good tax encourages thrift and industry
- A good tax discourages the excesses of the state
- A good tax does not divide – A good tax should reach every member of society except the very poor. All should know that government is not free.

The document went on to elaborate on those points. **Mr. Brooks** felt a broad based sales tax should be enacted. It would be enacted into law, allowed to operate for two years and

then the people would vote on it. He thought serious consideration should be given to the sales tax funding the state's share of education. In order to generate enough revenue to do that he thought it would be necessary to tax services. Some will say that due to Internet purchasing of merchandise, sales within the state or a given jurisdiction will remain static or go down. He submitted that in the 1970s when catalog purchases seemed to be the way to buy merchandise, the same statement was made regarding static retail sales caused by catalog purchases. That has not taken place. At the same time, it was said that wholesale distributors would disappear. Those wholesale distributors who were innovative are still alive and prospering. Some will buy through the Internet, but shopping is recreation and many people prefer to see and touch merchandise. As a former retailer, he maintained the Internet will not drive down statewide sales. Historically in the state of Montana, particularly as he had analyzed it in the Billings market, there has been a very steady increase in gross retail sales in the state. This would give education an automatic increase every year if the sales tax is used to fund K-12. He thought it should be studied very carefully and given serious consideration.

Questions from the Committee:

Sen. Harrington wondered if a sales tax funded education if all school districts within the state would be put in one system to set salary schedules. He asked if **Mr. Brooks** would still allow for property tax increases for school districts. **Mr. Brooks** said his concept was to replace the state mills, enact a constitutional amendment that those mill levies could not go back, and give the opportunity to the local community to fund education. **Sen. Harrington** clarified **Mr. Brooks's** point that the sales tax would cover the 101 state mills, but he wondered about any other increase for the state's responsibility. He asked if the sales tax was passed if new revenues should be used to fund programs or be revenue neutral. **Mr. Brooks** felt given the historical problems with the sales tax, a sales tax would by necessity have to be revenue neutral. The key is, if retail sales are funding education, in future years there would be additional money going to education funding. He did not want to remove local control and communities would still have a say in how they would treat their mill levies for education.

Mr. Watts stated if they do away with the 101 mills, that is about \$200 million. A four percent sales tax would generate about \$450 million. There would be \$250 million additional dollars and he wondered what **Mr. Brooks** suggested be done with the additional dollars or if he was suggesting a lower sales tax. **Mr. Brooks** suggested taking the additional revenue and lowering the income tax rate.

Rep. Peterson commented he subscribed to **Mr. Brooks's** philosophy and supported the idea of implementing the tax and waiting to have the people vote on it. He asked how they would get through the period of implementation and then the vote of the people without intervention through the petition process. **Mr. Brooks** advised education is the only way and it would take a tremendous amount of effort, energy and money. He felt the issue must be faced head-on and a statewide strategy be developed to educate the citizens and to ask them to give the process an opportunity work and see the end results.

He advocated a constitutional amendment that the 101 mills cannot go back on the books without a vote of the people.

Rep. Eileen Carney advised the problem she always had with a sales tax was poor people pay a larger portion of their income than rich people. If income taxes are cut, rich people are going to pay a whole lot less and poor people are going to pay a whole lot more. She asked why that is good public policy. **Mr. Brooks** contended they attempted to address that in **Rep. Peterson's** bill. He thought there were many ways to make the sales tax non-regressive. A base of \$17,500 could be used and there is a way to adjust the tax to make it fair.

Rep. Lake questioned pulling the 101 mills in property tax funding education. He asked where the funds collected from the property tax should go. **Mr. Brooks** said the local government has to have some way to function. The state legislature has authorized certain functions of local government and the property tax is one of the ways that can be accomplished. He thought they should not remove the school boards' authority as far as local property taxes and the funding of local schools. **Rep. Lake** indicated there was a statement made at the **Western Environmental Trade Association (WETA)** conference that basic property taxation should only be used for increasing the value of the property that is paying it. Local officials would be responsible for the property taxing structure. He asked for **Mr. Brook's** opinion. **Mr. Brooks** replied he was resistant to the implementation of HB 124. Yellowstone County commissioners held off until the very last. He thought only time will tell if HB 124 was a wise decision. He favored as much local control as possible and felt the best government is that which is closer to the people.

Sen. Bales asked **Mr. Brooks** about the idea of a sales tax abolishing the income tax. He didn't think there is enough revenue to do that. **Mr. Brooks** agreed there is not enough revenue with a four percent sales tax to do away with the income tax. He favored a reduction in the rate.

Anita Varone, Lewis and Clark County Commissioner, said she also served on the **Governor's Economic Development Advisory Council** but was representing the **Montana Association of Counties (MACo) Economic Development Committee**. She noted the committee was working with the **Montana Economic Development Association (MEDA)** and the **Montana Ambassadors**. They are partnering up on such issues as tax reform. The three committees will meet and then come together and talk about what they can support or ask for during the next legislative session. She indicated they would have recommendations to this committee after the first of the year.

Rep. Lake asked about HB 124 and how that is working for the counties in that current structure. **Ms. Varone** thought it was too soon to know. She agreed with **Mr. Brooks** that county commissioners are firm in their belief that they should and can manage the funds that come to them appropriately. If they manage it improperly, they simply won't be elected again.

Sen. Bales asked about the funding of county government and how **Ms. Varone** views county revenue sources and where they're coming from. He wondered if she saw it as simple, straightforward, incomprehensible or somewhere in between. **Ms. Varone** thought it is extremely complicated. She guessed it is less complicated for the counties that have a larger population than it is for counties that have a smaller population. To keep up with all the bills and responsibilities with a commission of three is extremely difficult. She thought it could and should be easier. **Sen. Bales** asked if she had any recommendations for a simpler way to fund county and/or city government. He said one of the purviews of this committee is to try to simplify the tax system and make it more straightforward and understandable. **Ms. Varone** said that is their intent. They hope the committee will accept their recommendations for review.

Ms. Whittinghill said there was some discussion at the Wheeler Center in regard to taxes from the perspective of economic development. She asked **Ms. Varone** how important she thought tax incentives would be in the future. **Ms. Varone** said her personal opinion was they are extremely important. She disagreed with those who said it really doesn't matter. **Ms. Whittinghill** asked what other pressures are coming up in the next ten or fifteen years on the expenditure side. **Ms. Varone** indicated Lewis and Clark County is in the process of looking at roads. Roads are in dire need of repair and maintenance. They floated a mill levy eight or nine years ago and it failed. They need to do that again and are not confident it is going to pass because the citizens feel they are already over-taxed. Providing some sort of relief to the citizens would give commissioners a chance to pass a mill levy.

Sen. Harrington said in the past **MACo** has come out with its own sales tax. He asked if **MACo** is willing to work with this committee or if they are they going to work by themselves. **Ms. Varone** advised her committee's intent is to work together with them. It will be a decision of the full board and membership of **MACo**.

Sen. Peterson requested that when they get close to a recommendation that they share it with this committee. He said the committee has to report by September of 2004. It would be helpful to have that insight prior to making their recommendations. **Ms. Varone** said her committee has invited anyone to listen and participate in the meeting on November 14. Their intent was to be open and share as much information as possible.

Mr. Watts asked about the location of the meeting. **Ms. Varone** indicated it would be held in Hamilton on November 14 at 8:00 a.m. in the County Commissioner Chambers.

Sen. Bales hoped her committee would look at ways of changing the tax system county commissioners would favor, making it easier and better for the counties. He hoped for that information as soon as possible. **Ms. Varone** said they would provide that.

Webb Brown, Montana Chamber of Commerce conveyed their philosophy of taxation was that it be fair, balanced and competitive. They felt the tax reform that was enacted in the past regarding the personal property tax has been effective and has accomplished good things for Montana. They felt the wage growth in Montana is in part related to that.

Businesses they surveyed indicated the reduction from six percent to three percent was not used just to increase wages or new jobs but to reinvest in their business, buy further equipment or simply to stay in business. The three percent is a more competitive rate. He cited the move of **ASiMI, Associated Silicon Materials, Inc.**, to Montana from Moses Lake, which he claimed was in large part because of the property tax reduction and the promise of further reductions. Property tax is the third largest expense at the plant. He contended incentives do matter on the margin and to individual businesses, especially those that are capital intensive. The Chamber has continued to support tax reform. At the **Tax Reform Symposium** at the **Burton K. Wheeler Center**, it was noted that always means sales tax in Montana. He thought it deals with a whole range of issues including the sales tax. Their position has been they would support a broad based general sales tax as long as it provides some relief. He provided some figures from a survey of **Montana Chamber** members and others including the **Montana Taxpayers Association**, **The Montana Automobile Dealers Association**, the **Helena Area Chamber of Commerce**, the **Montana Association of Realtors** and the **National Federation of Independent Business (NFIB)**. The survey found 84% of Montana Chamber and MTA members said they would support a sales tax. It was 3 to 1 that the legislature should enact it and slightly less when the other groups were included; 92% thought it should reduce other taxes. When the other groups were included it was 70%. On completely eliminating or replacing other taxes, only 52% voted in favor of elimination of other taxes. *(Tape 2, Side B)* Regarding revenue neutrality, 38% preferred that. The **Tourist Tax Committee** preferred a sales tax be much broader based rather than on the two or three industries in SB 407. They also feel that with the constitutional cap of 4% already in place, that lower rate would be sufficient to prevent the “tax creep” that people seem to fear whenever this issue is raised. They would like to see reductions in the income tax and especially the capital gains rates before the passage of the bill. They are embarking on a tour of state to talk to members in 17 towns about tax reform and will provide information to the committee. Even with the incremental changes in the tax system, folks are concerned about the property tax. He indicated that the legislature hasn’t really raised taxes but the valuations have gone up. Tax reform has resulted in a proliferation of fees.

Questions from the Committee:

Rep. Cohenour asked what survey results showed about freezing the business equipment tax at 3%. **Mr. Brown** said they did not ask that question in their survey but will ask it as they go around the state. Their position has been for the elimination of the personal property tax. The best tax incentive is the best competitive rate and zero is competitive with the other states that currently don’t have personal property tax. **Rep. Cohenour** asked how it would compare to surrounding states. She thought 3% was actually below competitive. **Mr. Brown** indicated Idaho has a personal property tax rate and Montana is slightly below. North Dakota has none. In a capital-intensive business, the personal property tax is a large part of their tax burden. Manufacturing jobs take a big hit. **Rep. Cohenour** advised she would like a copy of the survey results. She recalled the membership across the state was very supportive of increasing taxes if the money went to education. **Mr. Brown** indicated that was a **Helena Area Chamber** survey. The state

Chamber didn't ask that specific question. Generally, their position is a sales tax should go to the general fund and the legislature should decide where to appropriate it. Sixty percent of the general fund already goes to education. Higher Education, Public Health and Human Services, and Corrections are also funded through the general fund.

Sen. Harrington advised the cuts in the personal property tax and income tax cut in the last session would be about \$140 to \$150 million. It was his understanding the personal property tax would disappear because of growth in income if the next legislative session does not stop it. The new income tax will kick in for \$80 million. He asked about the responsibility to fund programs. He had voted for incentives but had not seen growth from reductions in the personal property tax. He asked about the responsibility to cover the costs of education, medical care, etc. **Mr. Brown** advised business benefits from the services that state and local governments provide. They favor an appropriate mix and an appropriate amount of taxation. He cited the issue of competitiveness. With a variety of taxes, there is rarely one reason why a business will come to a state or why they will leave. Regarding the contribution of the business share, the **Council of State Chambers** met and found business contributes 40% of the tax base for states. It is a matter of what services are provided. Regressivity is an important question but they believe how businesses are taxed has to be competitive, reasonable and balanced. Higher taxation is an issue affecting growth and whether a business stays in the state. They support the taxation of services as long as it is not pyramided on top of other taxes. They favor a sales tax as broad as possible with a rate as low as possible so that everyone is participating in the system. **Mr. Harrington** said whenever a sales tax is brought before the legislature many people feel they should be exempt. He asked if there is a responsibility and what it is. **Mr. Brown** addressed the participation of business and its contribution to the tax base; businesses are also residents of the state and pay a variety of other taxes besides the real property or personal property taxes. They pay a corporate tax, income tax, etc. Part of the reason for the condition of the state is corporate income tax in the state is down significantly because of the national economic downturn. The personal income that is generated out of investing in corporations is down. Those businesses are participating to a significant extent already. There are structures and tax rates in the state that make Montana less competitive with other states. Their concern is losing businesses to other states. He thought they were contributing significantly to the tax base in Montana. Business is not trying to get out of paying taxes. **Sen. Harrington** asked as income for the state keeps shrinking, if they could continue to keep cutting taxes as well as services. **Mr. Brown** said that is why they have supported the institution of broad based general sales tax. Business people will be paying the tax as residents of Montana as well as visitors to the state. The Chamber has supported increases in taxes, and not just decreases or cuts in taxes. **Sen. Harrington** asked if a sales tax is passed, many people feel this tax is needed to fund programs. He perceived the Chamber wants further tax cuts. **Mr. Brown** indicated members have said they would agree to a tax increase and this would not just be revenue neutral. It would not be dependent upon visitors paying. Business benefits from the structure and services of government and would be willing to accept that.

Mr. Ken Morrison addressed whether the people's view of the need for a balanced, fair and competitive tax system matches the views of **Mr. Brown's** membership. He asked for ideas or suggestions to educate Montanans on why it is necessary to change the system. **Mr. Brown** replied following the survey that was done through the legislative session, they participated in a poll with the **Bureau of Business and Economic Research** at the **University of Montana**. The result was 51% to 48% in opposition to a general sales tax. The general public would like to see both property and income tax reductions. He felt there was a lot of misconception regarding "tax creep"—the fear once a sales tax is in place either it will be raised or taxes that had been eliminated or reduced would be re-instituted or increased. The **Montana Chamber** has generally been opposed to writing tax policy into the Constitution. The public needs some reassurance. He was not sure that could ever be guaranteed. Dealing with the perception that the legislature has raised taxes over the past two sessions—he was not sure how to educate the public other than hammering away with the facts.

Rep. Carney advised that main street businesses in Montana depend on spending by the middle class. If property taxes or income taxes are cut, people in her district are going to get back \$100 or \$200. They will spend a whole lot more than that on a sales tax. If sales taxes are raised middle class people will pay more, which means they can spend less money. She asked **Mr. Brown** about the effect on Montana's main street businesses. **Mr. Brown** said the impact is to everyone but it would have to be balanced out. If four percent is paid on purchases—and medicine, medical services and food are exempt—people have the flexibility to decide what to spend on luxury items. One of the objections to a sales tax is with big-ticket items such as automobiles or jewelry. Auto dealers in Billings have said they can still be competitive with Wyoming. People will make the decision of what they will pay based on other factors, not just the amount of sales tax. He didn't think a sales tax would drive people not to make purchases they would have made whether that sales tax was in place or not. He hadn't seen anything to indicate they are or aren't going to make purchases.

Mr. Watts asked if there is a typical four percent retail sales tax on goods and services, how much of that would be paid by businesses. **Mr. Brown** could not recall. **Mr. Watts** asked if it would be more or less than the business equipment tax. The business equipment tax was about \$50 million in tax revenue last year. They think that businesses will pay more than that in the sales tax. **Mr. Brown** indicated it would depend on how it was structured.

Rep. Lake said they're hearing the need for relief of some other taxes to make the whole taxing system fair. He asked if they were to initiate a sales tax where **Mr. Brown** believed they would get the greatest benefit for economic development from tax relief because of a general sales tax—would there be a reduction in property tax, personal property tax or income tax. **Mr. Brown** was not sure. If there was a reduction in residential property tax, that could be spent on goods and services. He didn't think the trigger would be hit for the business equipment tax in the coming two-year period. If that was reduced further, there might be an increase in manufacturing in Montana. Manufacturing contributes significantly. That would have to be offset against what

people would do with that money—whether they put it in savings, spent it or reinvested in their business.

Rep. Cohenour addressed the business equipment tax and the argument it needs to be reduced to be more competitive to keep business here. The national market is such that businesses are more mobile, she contended, and more easily moved. She felt businesses come to Montana and accept the incentives that are offered and then move to another state that gives them an exemption of some kind. She didn't think incentives should be given to the point where it is starting to hurt the infrastructure. She wondered about the responsibility of citizens and business owners to provide the infrastructure. **Mr. Brown** said they believed most incentives have been in the form of advanced credits or things that have not diminished the capacity of the state or local government to receive some return. He agreed business is mobile and people move to another state because the income tax rate is lower as well. At the same time, it is important to have the economic activity. As long as the incentive is not diminishing capacity, it is great to have a business for four to six years even if they do shop around and move on. People are employed during that period and paying income taxes, etc. The tax incentive is important because in certain circumstances it will make the difference. It should be structured so it will not diminish capacity.

(Tape 3, Side A)

- Break 10:30 -

- Reconvene 10:40 –

Daniel Watson, Rosebud County Commissioner, stated he currently serves on the **Tax and Finance Committee** for **MACo**. The committee is going to be looking at tax reform for the next legislative session. The plan is to dust off a previous proposal. Some of the issues that were in the previous proposal have been addressed such as motor vehicles, livestock inventories, business inventory and several others. They will invite other stakeholders to participate such as the **League of Cities and Towns**, school board superintendents, stock growers, etc., that have been involved in the sales tax issue in the last several sessions. They are hoping to come up with a general consensus. Part of that process will be to take a number of the bills that have been presented in the last two legislative sessions, go through those and get a feel for their common points and differences and try to come up with middle ground. They will be meeting on November 6, 2003 to put together a list of people and go through the bills. He was not familiar with the **MACo** proposal, but **MACo** has dealt with tax reform and the sales tax for 25 years. They hope to make a proposal to the **Tax Reform Study Committee** at a later date and would like to work with the committee. Several committee members would be invited to participate in their process.

Questions from the Committee:

Sen. Bales noted **MACo** was a strong supporter of HB 124 and assumed the majority of counties still were in support. He asked if they are just looking at the sales tax or all the funding of county government and the revenue stream going into county government.

Mr. Watson said they were primarily looking at tax replacement. In the case of Rosebud County, taxable value has decreased by more than 50% since he took office. They will be looking at the effects on local government. They would like to include schools, cities, and special districts. They will look more at property tax than income tax. Previously they had looked at personal exemptions and tax brackets as a way of providing tax relief.

Ms. Whittinghill asked of the 50% reduction in taxable value in Rosebud County, how much was being reimbursed. **Mr. Watson** indicated 90%, but part of the reduction is due to phase out and part is due to market value. They were also affected by the phase out of livestock and business equipment because of the natural resource base in the county—coal mining and electrical generation—and agriculture. **Ms. Whittinghill** asked if they are being reimbursed 90% for the changes due to tax reform. **Mr. Watson** said that was the case. Rosebud County went on record as a supporter of HB 124 because of the tax base.

Rep. Peterson hoped the **MACo** committee would incorporate tax reform already in statute and discuss how that will be implemented. Currently there is limited tax reform in the areas of income tax and capital gains tax. \$70 million that was earmarked for that implementation is currently going into the general fund. In two years, they have to raise \$70 million to implement that tax reform, make cuts, repeal the tax reform or substitute comprehensive tax reform for that statute. He thought it important the two committees interface. If they can find some agreement on a proposal they can go forward as a group. He thought it important to agree. **Mr. Watson** agreed and stated past and future tax relief is their impetus. They are aware of the upcoming changes and those will be part of the discussion.

Sen. Bales addressed the valuation in Rosebud County and asked if part of that was due to the incorporation of Colstrip. **Mr. Watson** said the primary effect of the incorporation of Colstrip was on the road department. The road fund went from a little more than \$170 million down to a little more than \$30 million. As a result, they laid off half of the workers and sold equipment to keep the fund solvent. They now operate a maintenance crew where before they had a construction and maintenance crew. **Sen. Bales** asked if they wanted members of the committee to meet with them. **Mr. Watson** said they would extend an invitation to several members of the committee.

Gail Patton, Sanders County Commissioner, advised their local newspaper just published the mill levies for the county with the headline “Ouch! Tax Bills Don’t Bring Good News.” (*Exhibit 2*) They had a sharp increase in the mills in all localities. Part of it was mill levies passed to build the gym in Hot Springs and part was due to the PPL tax protest in Thompson Falls. The floating mill has raised the tax; the budget is the same. The situation in Dixon included construction; the budget is the same but the value of the mill went down. It is a poor community because the tribe keeps buying up property. It comes off the tax rolls and the taxable value is deducted. They had a lot of construction in western Sanders County and an influx of new people moving in asking for more services, including retirees and those moving to subdivisions. In Hot Springs and Thompson Falls the taxes on a \$100,000 house went up from \$1900 to \$2250. Part of

that is because of the shift in personal property taxes. His taxes are lower as he has cattle and machinery. Those in town are the ones he gets telephone calls from, but he thought maybe they get more services. They also lost some taxes from the Blackfoot Coop. Taxable value went from 6% to 3%, which cost the county \$800,000 for schools. The Yellowstone pipeline where it crosses the reservation came off the rolls because it closed it down. The protested taxes in the school district in Thompson Falls are \$450,000. Those have been received and the district is spending them. The county is not spending the protested taxes as this may go on for five years. If they lose, they have to come up with the money. The senior citizens have a voted levy of about \$88,000 for seven senior citizen centers in the county for transportation, etc. The protested taxes come to about \$5000 for them. The county told them not to spend it unless there is an emergency. If PPL wins their protest, the seniors will have to come up with the money and really cut spending. Personal property tax cuts have helped, he felt. A new firm from Idaho and one from Oregon moved in. **Jore Corporation** went bankrupt and was bought out. They have a lot of equipment, and part of the decision to keep the firm in Ronan was the personal property tax. **Jore** and **Semitool** are experiencing layoffs. He thought Montana would never be a major manufacturing center because it is too far from the markets and Montana has trouble competing. Competing in heavy industry is also difficult, but is one of the best sources of tax. The railroads, the power dams, fiber optics or the pipelines can't be moved. He thought it foolish to lower these taxes any more. He saw no reason to give **PPL** or **Avista** additional revenue. Their costs are passed on and amount to a sales tax on the consumer. Last session a bill from **Sen. Ken Toole** would have put a gross receipts tax on **PPL**. He thought if a gross receipts tax is put on centrally assessed or power companies, it should be straight through, not just on **PPL**, which would create a lot more revenue. The largest hydroelectric dam is at Noxon. He mentioned their budgets are just as tight as they can be from the county perspective. A lot of people have the notion that the county commissioners are raising their taxes. In his county about 22% goes to the county and the rest goes to schools and the other special districts. They are having trouble keeping their sheriff's department financed and within budget. They will ask for a mill levy after trying twice. The headline he mentioned makes it difficult to get mill levies through, he maintained.

Questions from the Committee:

Sen. Bales asked about the tribes buying up the land. He asked what percent of land in the county is under tribal ownership and what problems that creates. He wondered if there is any solution to that problem. **Mr. Patton** advised the Flathead Tribe (*Tape 3, Side B*) has a long-term policy to buy all the land back. They are buying up all the cheaper land and putting it in trust. If land is put in trust, it is not taxable. Less than one third of the county is on the reservation. It hurts Hot Springs and Dixon the most.

Rep. Lake asked **Mr. Patton** about his tax solution. **Mr. Patton** advocated a broad based sales tax. He doubted one would pass. He didn't think property taxes could be cut any more. He didn't think government could become more efficient. The county road crew uses second hand equipment. They try to keep costs down as much as possible but

health insurance and workers compensation insurance costs go up. The school district needs more money.

Sen. Bales asked if a sales tax is enacted, and property taxes are reduced, would counties immediately raise property taxes and take it back to where it was. **Mr. Patton** said their position was to take it to the voters. The voters can turn it down or pass it. He thought local people should solve local problems.

Rep. Peterson said one of the concerns regarding a general sales tax has always been “tax creep.” He wondered how to convince citizens otherwise. He asked what the county’s reaction would be to a constitutional cap to prevent both statewide and county mills from going up in order to pass a general statewide sales tax. **Mr. Patton** replied it depends how far the sales tax goes and on exemptions. The percentage of the tax isn’t the whole thing. He thought the tax needs to be broad and he supported a sales tax on real estate exchanges. **Rep. Peterson** asked if counties would accept a constitutional cap on mills. **Mr. Patton** indicated it would depend on how the sales tax is distributed.

Riley Johnson, National Federation of Independent Business (NFIB), stated the organization is 8000 small businesses in Montana. The average member employs two to three employees and generates about \$250,000 in gross sales. They cover almost every sector of small business from agriculture to main street businesses. They use ballots of members to take positions with the legislature and state government agencies. **NFIB** advocates a fair and balanced approach. A ballot is going out and results will be due in January. The sales tax is the basis of any discussion on tax reform whether broad based or narrow. They are addressing the business equipment issue on the ballot. The information will be shared with the committee. They polled the membership on the sales tax in 1993 and the vote was split. In 1997, the vote was 51-49. A ten-point spread is required in order to take a position. They did a fax ballot this year in conjunction with the **Montana Chamber** and 68% favored a broad based sales tax. The public vote issue was a fifty-fifty split. Comments included that in any modern society leaders must make decisions on major issues because the populace doesn’t understand or doesn’t care. They have a fax alert network of 4800 small businesses and he offered that as a resource to the committee. In talking to members, he thought the 68% who favored a sales tax are saying the sales tax should be on the table to consider as part of a tax reform package. There are many unanswered questions but the public is ready to take a realistic look, he felt. The membership survey will include whether to offset other tax cuts with the sales tax, whether to make it revenue neutral or new income and whether it should go to a vote of the people. He thought this is an important issue and he wanted to poll the membership again instead of relying on last year’s survey. He was happy **Rep. Carney** and **Rep. Cohenour** were representing low income people and the working class. He thought it was important to address whether lower income people were paying more in proportion. Larger businesses are also represented on the committee. He thought the issues such as the centrally assessed versus non-centrally assessed, lower income, higher income, etc. could be addressed. He observed that members definitely felt a reduction in property tax should be offset with a sales tax. He described the property tax as “phantom economics.” Property tax is not based on cash in the pocket or on profit. He thought a

large percentage of Montanans pay more property taxes than state income tax. He thought property tax was where relief was needed. He thought the state should be taken out of the property tax business and the property tax turned over to local governments. The state would have the sales tax and income tax, it should all go into the general fund and the leaders of the state should make the decisions. Income taxes and sales tax are based on consumption or real economics—not phantom economics. He also addressed the idea of developing accounts to get through rough times. Health care costs and health insurance for state employees are going up. Workers comp is going up 34%. Regarding the business equipment tax, he will ask his members, but he felt “a deal is a deal.” The question of tax policy stability should be on the table. Several companies have either come into the state or have made major expansions because of the promise made in 1999. He asked if breaking that promise was good public policy. He thought the money has come back in the form of new jobs, expansion, new equipment purchases, etc. His final point was the taxation put in place in the last session—the tax on rental cars and lodging—should be taken off as an issue of fairness. He commented business should pay its fair share. Small businesses are 97% of all employment and the only sector generating new employment every year. They create jobs, profits, and taxes. The more that is limited, the longer the local government and state government budgets are going to suffer, he contended.

Questions from the Committee:

Rep. Lake asked **Mr. Johnson** about his “dream world” taxation structure—a mix of the revenue required and the fairest way to bring in revenue. **Mr. Johnson** said he hasn’t surveyed a “dream” tax. Personally speaking, he thought a broad based sales tax is needed. He needed to know how much would be raised and what the money would be used for. He thought the property tax should be a local option. Some caps should be instituted on “tax creep” and also government spending such as in **Rep. Dave Kasten’s** bill from the last session. He didn’t think the bill had enough discussion to fully flesh it out. Property taxes and mills are confusing to the average person and that should be simplified like the income tax. **Rep. Lake** asked about the 12% tax on electrical generation and transmission. The **Public Service Commission** takes that tax as a direct pass through as far as rates go. That makes electric bills a tax collection system. He asked if there are any other states with the same style. (*Tape 4, Side B*) **Mr. Johnson** thought the issue of centrally assessed versus non-centrally assessed is an issue that has to be brought up and addressed with the business equipment. There are businesses in the state that aren’t paying 3%; they’re paying 12%. There is a reason for that, but he asked if it is fair. It is a pass through and has to be addressed. If all the business equipment tax is eliminated, there is a legal problem with some businesses being taxed and some not at all. He indicated **Ms. Whittinghill** could answer the question regarding other states.

Rep. Carney advised one of the ways main street business loses is because of big box stores. She wondered if **Mr. Johnson** had ever asked his members what they think about a gross receipts tax to equalize the situation. **Mr. Johnson** said he has not asked the membership. He heard rumblings on both sides and comments about the nature of business today. He has heard that it is hurting businesses and would be willing to ask.

Rep. Peterson asked if he had discussion with the members with regard to a broad based general sales tax versus a local option sales tax. **Mr. Johnson** said he had never discussed it as an either/or or as a combo. Members are against the local option tax. They are for a statewide broad based sales tax program. He thought members don't trust local government. They don't understand what they are paying for. They like local control, local school districts, etc., but would rather have the state dictate because they don't understand the system. They could make a decision on a local option tax if they understood the system, he maintained.

Sen. Harrington asked him about his statement "a deal is a deal." He said that was a very controversial political decision and one day it may be changed. He asked if **Mr. Johnson** really believed "a deal is a deal." **Mr. Johnson** said he would defer that question until he gets the results of his survey. He thought it is good public tax policy to develop a system that is consistent. He didn't know if that decision was made contrary to public policy. He thought it was bad public policy to go back and change things every few years. **Sen. Harrington** asked if leaving the tax at the current level would be changing public policy. The law says if certain things occur it will go down. Public policy currently is 3%. **Mr. Johnson** indicated public policy says if the economy in the state reaches a certain trigger, the tax will go away. He thought the business equipment tax is a regressive tax on business, particularly capital-intensive businesses.

Sen. Perry said the majority of employees in the state of Montana are employed by small businesses. So many small businesses expanded by purchasing new equipment and hiring new employees and if they did not follow through with the reduction in the business equipment tax, it would hurt small businesses throughout Montana. **Mr. Johnson** felt small businesses are the economic engine that drives the state; they pay the bills for the state because of the income they create and the property and income taxes, etc. they pay. As result, he thought it was unfair to tax small businesses on equipment when the money could be used to expand, hire, etc. He thought the business equipment tax was a poor part of public tax policy. He thought a broader approach to taxation should not include the business equipment tax.

- Recess for lunch 12:00 noon -

- Reconvene 1:11 p.m. –

Warren Ernst, a farmer from Stanford, represented himself and said he was a member of the board of directors of the **Montana Grain Growers Association** supporting the wheat and barley industry in the state of Montana. They would like to continue the reduction and the elimination of the business equipment tax. They use a lot of equipment in the farming business with little opportunity to pass on the cost of that tax. In drought years, when they have no income, they still have to come up with the tax. The Association is in the process of developing tax policy positions. In December, they will have a policy drafted on what they would like to support. As a farmer, he encouraged the elimination of real property taxes if there is another form of tax like a sales tax. He said

he could pay about 2.5% to 3% sales tax on all his spending to equal his property tax currently. He thought a sales tax is broader based.

Questions from the Committee:

Rep. Lake asked **Mr. Ernst** about the elimination of the property tax bill and if it was the whole property tax or just the 25% that represents the state. **Mr. Ernst** indicated the total property tax bill.

Kathy Brown, Past Chair Tourism Advisory Council, presented a letter from current **Chair Ramona Holt**. (*Exhibit 3*) She didn't think the 3% should all be lodged on just accommodations. It makes more sense for a more broad based tax. She indicated she also works for **Alan Nicholson**, the developer of the **Great Northern Town Center**, who advocates a broad based sales tax. She referred to an article from the *Montana Business Quarterly*. (*Exhibit 4*) The tax base is dropping and residential and commercial property taxes are going up. The hotel and restaurant that were just built in the **Great Northern Town Center** have a bigger tax collection than **WalMart**. If **WalMart** was collecting a sales tax it would be a more fair and equitable solution.

Nancy Schlepp, Montana Farm Bureau Federation, said their position on the subject of a sales tax had not changed since the legislative session. Their policy is made by voting at their state convention and those are the only things they are allowed to lobby on. Their policy says they support a sales tax as long as it is revenue neutral to agriculture. They have not found a local option tax that has been revenue neutral to agriculture. Every one has pulled money from rural communities and distributed it to the larger economic bases, which makes operating county government even more difficult. Money from a state sales tax should go to property tax relief, especially if it was just the 101 mills. A sales tax should not go to the voters, but should be enacted for at least two years before being voted on. Relief in property taxes is essential to the tax base. In Meagher County, a mill was worth about \$9000 two years ago and is now worth \$7000. The only way to raise more money is through property taxes, which puts a bigger burden on that part of the industry. Regarding current tax changes, Montana farmers and ranchers have been kept in business. She mentioned any time a policy change is made, it takes about 3-5 years for that implementation to catch up. She thought they should consider that when making their deliberations.

Questions from the Committee:

Rep. Lake asked about her recommendation that a broad based sales tax be revenue neutral to agriculture. He wondered if she meant the business of agriculture or farm families. **Ms. Schlepp** advised when they figure agriculture dollars, they do not use the multiplier effect. Whenever she talks agriculture, it means family owned farms and ranchers. She thought it was good to think about the multiplier effect and what it means for communities.

Ms. Whittinghill asked **Ms. Schlepp** to elaborate on mill levies. **Ms. Schlepp** said in a lot of rural communities the tax base is struggling. Part of the problem is a larger part of the ranches are being sold into trust, become 501 (c) (3) corporations and are not being taxed. When property is not taxed it becomes a bigger burden on the ones that are taxed.

Gail Abercrombie, Montana Petroleum Association, advised her association represents all the exploration and production of producers of oil and natural gas from the pipeline, which is centrally assessed to refineries that are impacted by the business equipment tax. On oil and gas production, competitive, consistent and simple taxes are the best way to go. The Association worked with **MACo** when they brought their sales tax proposal forward. There are concerns about input to refineries and the types of equipment they have to buy and how that will be treated in a sales tax. The petroleum industry uses tanks and in most cases a tank is taxed as business equipment. If a sales tax is enacted and there is still a business equipment tax it would be an added tax for this piece of equipment. Another way to treat that would be to eliminate the business equipment tax and have a sales tax. There is already an excise tax on gasoline. She wondered about a sales tax on top of the excise tax. The excise tax is per gallon and the sales tax would be on value. She wondered if gasoline would be exempted because of the excise tax. Otherwise, if Montana has a higher sales tax, would trucks bypass Montana gas stations? Regarding taxation on services, oil and gas producers often hire a “land man” as an independent contractor and she wondered if a sales tax would be added onto their bill to producers. Refineries and mining companies have “turn arounds.” They bring in contracted crews from out of state and she wondered if there would be a sales tax on that service. Competitive, consistent and simple is what they prefer.

Questions from the Committee:

Sen. Bales asked her to elaborate about pipelines and centrally assessed. **Ms. Abercrombie** indicated the Yellowstone pipeline is centrally assessed. Montana’s 12% rate is high. A crude oil pipeline pays about \$5 million in taxes in Montana and about \$250,000 in Wyoming. The Yellowstone pipeline is tariffed. The tariff is decided by FERC. The consumer pays in the price of fuel. The pipeline charges their taxes to the crude products they are carrying. **Sen. Bales** asked if her association has any policy on the oil and gas taxes and how they are collected and distributed. **Ms. Abercrombie** said the tax simplification that passed in 1999 has been working and there is a benefit to the state. As far as distribution, she needs to work with the **Department of Revenue** and the coal counties for simplification.

Peggy Trenk, Montana Association of Realtors, advised her association is going through a revamp of their policies concerning the sales tax. They only support a general sales tax if there is a constitutional elimination of property tax or income tax. (*Tape 4, Side B*) They feel certain groups need to be exempted such as first time homebuyers. She raised the issue of taxing real estate services such as fees, attorneys, brokers, and title searches which would put additional costs on closing and mortgages.

Questions from the Committee:

Rep. Lake addressed the realty transfer tax that is due at the time of closing. **Ms. Trenk** said there is not that much revenue associated with the realty transfer tax and repeated certain groups should be exempt such as first time homebuyers.

Sen. Perry said a large number of out-of-state people are buying high priced properties in Montana. Residents of other states buy land at high prices and drive up prices for Montanans. They pay no income or sales tax. Yet the Association supports the burden shifting to out-of-state folks as much as possible. **Ms. Trenk** advised yes, with the sales tax. **Sen. Perry** thought it logical to consider a realty tax on out of staters. **Ms. Trenk** said several bills have tried to do that. There is a concern about legal equity. This kind of surgical fix sweeps in other people such as second home sales, family cabins, etc. It is difficult to separate a particular class of buyer. There is a philosophical issue with penalizing wealth. Some of those folks spend a minor part of the year here. They are paying property taxes for services they don't have a use for. **Sen. Perry** said if it is difficult to separate certain classes such as out-of-staters, it is also difficult to segregate real estate buyers from other purchasers of consumer items on which they pay a sales tax. He recognized realtors oppose such a tax, but if this is not discussed there can be no progress by the committee. He asked **Ms. Trenk** to present to the committee her logic in segregating a real estate transaction from a sales tax or transaction fee. **Ms. Trenk** advised she was not sure other states tax real estate transfers as part of a sales tax. It is not a consumable good; it is an investment. She said they will think this through and all issues should be on the table. They don't believe it is a productive reform issue. She offered to put information together for the committee.

Sen. Peterson said they looked at replacing the 101 mills with a sales tax. One of their proposals was instead of eliminating the 101 mills, they would allow all Montana residents who file an income tax return to get 100% credit for the 101 mills on their income tax. If you didn't file a Montana tax return, you couldn't get the credit. They were not discriminating against out-of-state homeowners, but were only providing the 101 mills property tax credit if you filed a Montana tax return. He asked if the association had talked about that kind of approach and what their position might be. **Ms. Trenk** said they don't support separating people out. Part of it is related to reappraisal and trying to figure out measures to deal with that. An idea to tax those who don't live in their homes swept in rental properties and a variety of other properties that impact renters and investors. It is not as simple as it sounds, but they are talking about the issue.

Ronda Carpenter, Lobbyist, indicated she was a little confused about who she was representing. She has a number of clients who support a general sales tax that would replace statewide mills, some property taxes, replace the capital gains tax, help eliminate the business equipment tax, and adequately fund the necessary services in government. When she got the letter from **Sen. Bales** she quickly emailed it to clients assuming she would be supporting a sales tax. Those who chose to respond said "Do you think if we don't go to the meeting they would just leave us alone?" She recalled traveling in seventeen states during the summer. In every state, the problems were not paying teachers enough, not funding social services enough, taxes are too high, children are

leaving the state, and no businesses are coming to the state. She thought it is more of a perception problem than it is reality. What the state has collected in mills in actual dollars over the last ten years has gone down. What the counties are collecting has gone up with the cost of living, inflation and rising insurance costs as a statewide average. Voter approved mill levies are what has gone up, she contended. Her clients favor stability and time to find out if new tax policy is working. One client asked if there could be a moratorium on interim tax committees. They want to make some business decisions and some investments knowing what the law looks like in Montana without worrying that before the ink is even dry on their income tax forms the law changed. She advised stability and letting policies play out unless there can be total tax reform.

Questions from the Committee:

Rep. Peterson said if they let SB 407 play out and in two years they have to implement income tax reform and capital gains tax reform, he guessed her clients would support the capital gains side. The \$70 million it will take to implement that is currently going into the general fund. He asked if the \$70 million should come out of cutting expenses, looking for new revenue, or building SB 407 into a more comprehensive package. **Ms. Carpenter** said her opinion was SB 407 needs to be built into a bigger package. The capital gains tax reforms were something her clients all did support.

Sen. Perry asked **Ms. Carpenter** if her clients consider the change in the income tax rate to be revenue neutral, a tax cut or a tax increase. **Ms. Carpenter** indicated it affected them differently. For larger business clients, it was a tax cut to some extent. She knew the capital gains changes will be a tax cut to them when they get ready to sell their businesses. **The Great Falls Chamber of Commerce** was pleased with the capital gains tax cut.

Mary Whittinghill, representing the **Montana Taxpayers Association**, advised they support broad based tax reform and looking at a long-term solution. She handed out their tax digest to all the committee members earlier so they could look at the various taxes currently imposed on Montanans. She did not think they were talking about a three legged stool but more of an octopus or centipede. A variety of taxes are going to start impacting everyone. The insurance premium tax will cause insurance costs to rise. They also suggest expenditures will increase in Montana and it would be interesting to see if the new tax would cover even these potential increases. The K-12 renewal commission met on school funding and the litigation on school funding is set to begin in January. There is a potential significant increase in revenue requirements that could occur. There is a lot of discussion about the retirement plans for public employees and teachers. There are significant costs the state experienced on workers compensation premiums. She thought it would be appropriate to look at expenditures that could potentially be affecting the general fund in Montana. She thought they should look at what services and expenditures can be realistically afforded. On the revenue side there are a variety of taxes that are being imposed. There are a significant amount of fees that Montanans pay. As a result of HB 124, vehicle fees are sent to the state. As part of the budget solution last session, the fees on motor vehicles were increased. As something is moved away

from the source, the tax does not become as visible, she contended. Fees can be used as a mechanism for general fund revenue. The Association supports the principles of taxation and thinks there should be principles for expenditures. She advocated basic public policy should not include one-time expenditures to fund ongoing operations. There should be a 5% general fund ending balance so there can be additional revenues when there are ebbs and flows. She addressed the business equipment tax. In a survey, 71% of 130 of those surveyed answered positively to the reduction from 6% to 3%. She agreed with letting things work before changing the policy. They support further reductions in the business equipment tax if the revenues are available. She noted since 1995, 53% of the costs of tax reforms that have been implemented were passed on to residential property owners in the state. If major tax reform is passed and there is need for additional revenue, the association would support additional revenue within reason. They would like some assurance another tax won't be implemented without monitoring expenditures. She was not sure they would support a super majority requirement. She thought education of taxpayers would be very important in order to achieve tax reform. There has been no significant tax reform nationwide since Wisconsin passed an income tax. They would work with the committee on grass roots efforts to educate and get the citizens' input. She read from a letter from Scott Brown of **ASiMI** regarding the decision to keep the plant open in Butte. It had a lot to do with the business equipment tax reduction. He said he "strongly believed the state should tax commercial activity such as purchases and sales and economic success, revenue or profits." He didn't think they should tax business assets. "Taxing assets discourages investments and penalizes already hurting capital intensive businesses in slow economic times." She gave the committee members an email from **Dick King, Missoula Area Economic Development Corporation** in regard to capital gains and property taxes. (*Exhibit 5*)

Rep. Lake asked **Larry Finch, Department of Revenue** about taxation on trust lands, etc. **Mr. Finch** deferred to **Dave Woodgerd, former Chief Legal Counsel, Department of Revenue** who indicated there were some U.S. Supreme Court cases involving whether or not the state could tax lands owned by Indians. As long as those lands could be bought and sold it didn't matter if the Tribe owned them or an Indian owned them, they could be taxed. The Tribe or an Indian can put the land into trust, which transfers the legal ownership of the land to the federal government. It is not then taxable by the state. **Rep. Lake** asked if any other trusts fall into this non-taxation area such as land preservation trusts. **Mr. Woodgerd** said most of those entities are taxed as long as the federal government is not the owner. (*Tape 5, Side A*)

Sen. Perry described a transaction where the person who bought the land donated it to a church, an out-of-state entity, in order to avoid taxes in Montana. The property was taken off the tax rolls, which increased the burden on the surrounding ranches. **Mr. Woodgerd** said he was not familiar with this but he recalled the statute on exemptions for property taxes only allows for religious purposes if the property itself is actually used for religious purposes. The **Department of Revenue** was diligent in making sure if there was excess property that wasn't actually used as a house of worship or some other religious purpose, it was not allowed the exemption. **Sen. Perry** advised some farms have been put in trust as a 501 (c) (3). The property is taken out of the tax rolls and the burden on surrounding

ranches is increased. **Mr. Woodgerd** said that may be happening. There are some exemptions for charitable organizations. It depends on the particular facts of the situation.

Rep. Lake requested information on the taxing of trusts. **Mr. Patton** advised the Flathead Reservation was opened up to homesteading. The Tribe owned timberlands and some allotted lands. Some allotted lands were sold to other people. During the depression, federal legislation was passed because tribal members were losing property when they couldn't pay their taxes. They were allowed to put their property in trust. It can be taken out of trust and sold. Since this decision, the tribes have bought land off the reservation for casinos. One of the things that affects county garbage districts is when a tribal member uses the garbage dump just like everybody else. If a taxpayer doesn't pay his garbage fee or taxes, their property can be taken. If an owner has no tax bill, there can be no tax lien.

Mr. Finch said in addition to this committee and the **Property Tax Reappraisal Committee**, there is a third interim study committee that is dedicated to looking at property tax exemptions in the state. He thought it would behoove this committee to touch base with them. They will be looking at these types of exemptions in detail such as religious, charitable and tribal.

Sen. Bales asked if the exemptions committee met. **Ms. Whittinghill** indicated **John Grimm, Department of Revenue**, is the staff person for that committee. The charitable and church example did come up in their meeting, in particular, the one in southeastern Montana where a large chunk of farmland was purchased. The church was growing produce and using it. There are other examples where people have donated a car to a church and tried to get a charitable contribution. That committee is not meeting again until after the first of the year, but she thought an update from **Mr. Grimm** on some of these questions such as the 501 (c) (3)'s and the conservation exemptions would be useful. Sometimes land doesn't come off of the tax rolls but development is prevented. It restricts the growth of the tax base in that way.

Jackie Williams, Department of Revenue, advised the **Property Tax Exemption Committee** met on September 22. They have the smallest budget of all the committees and they are going to try a conference call. Their membership list is on the website and the minutes of the meeting will be found there as well. **Sen. Bales** requested copies of the membership list.

Mr. Finch informed the committee that Friday, October 3 was **Brad Simshaw's** last day with the state.

Sen. Bales advised at the last meeting they discussed having a synopsis of previous interim tax study committees and wondered if that had been accomplished. **Mr. Finch** said he had not had time as most of the focus was on the work of the subcommittee. He has the studies on his desk. **Sen. Bales** asked if the legislative staff could help since the department is short of staff. **Mr. Finch** acknowledged they are short handed and the

assistance of the legislative staff would be helpful. He thought since he already gathered the final reports, it would not take a long time to pull it together. **Sen. Bales** asked **Jim Standaert, Legislative Services**, about staff time. **Mr. Standaert** advised he could put in some time on it. **Mr. Finch** advised **Mr. Standaert** is looking at the expenditure side for the subcommittee.

Jeff Martin, Legislative Services, stated he also staffs the **Interim Revenue and Transportation Committee**, and offered his services to the committee. **Sen. Bales** addressed a timeline to get requests done since the department is short handed. Another request was for what other states have done. **Mr. Finch** said on his desk he has four or five study committee recommendations from other states. He and **Dan Dodds, Department of Revenue**, attended the National Federation of Tax Administrators Conference. It is the revenue estimation and tax research conference. They visited with people from all over the United States and it is hard to find a state that doesn't have a blue ribbon committee discussing tax reform and tax options for their state. He thought hard economic times for the states tend to drive these types of committees. Focusing on the west or on neighboring states would be useful and could be accomplished. **Sen. Bales** advised they were looking for states that had undergone tax reform successfully, how they did it, and what the results were. **Mr. Finch** said examples of states that have done comprehensive tax reform on the level this committee is contemplating would be rare. In the state of Washington, a tax study commission recommended the state adopt a personal income tax and a value added tax.

Ms. Whittinghill advised Nevada went through extensive tax reform. She thought it would be helpful to have the executive summary of some of those tax reform committees. **Mr. Martin** advised he would be happy to work with **Mr. Finch** to figure out the best way to approach that. In the early 1990s there were also a lot of tax reform commissions. He had stacks of books on his shelves of tax reform studies at that time. He cited an article by Terese Wright who was involved in a number of tax reform studies in the early 1990s that followed the success of these efforts, which he offered to provide to the committee.

Rep. Cohenour asked how difficult it would be to look at surrounding states. **Mr. Finch** thought limiting the scope of the study to fewer states would be easier. He thought there may be sources that have looked at this already. He didn't think it would be too large a task to look at states west of the Mississippi.

Sen. Bales advised the subcommittee met once and thought there would be a report ready for the November meeting. **Mr. Finch** said that was correct. **Mr. Dodds** had pie charts and tables of supporting documentation as well as other documents that provide descriptions of the terminology used when looking at these pie charts. **Mr. Standaert** has something similar on the expenditure side. They can meet with the subcommittee or email the information. Then it could be presented to the entire committee and discussed at the next meeting. **Rep. Peterson** favored emailing the information.

The committee scheduled their next meeting on Wednesday, November 12 at 8:30 a.m. at the **MACo** building. **Sen. Bales** advised he talked with **Rep. Ron Devlin** of the **Property Tax Reappraisal Committee** and didn't think they would be ready to meet with this committee until sometime in January. (*Tape 5, Side B*) **Sen. Bales** asked what else the committee wanted from the department. **Ms. Whittinghill** said it would be nice to get a list of revenues associated with the various taxes and the impact of reforms on the federal exporting of the non-deductibility of the income and property tax and estimates on that. **Sen. Bales** said he had some questions also on the non-deductibility. They need to know the impact. **Ms. Whittinghill** asked if an inventory of the various taxes and fees that are being imposed in Montana would be mailed to them. Eventually they will want to evaluate those various taxes and fees in terms of the principles of taxation. She wondered if they would have the breakdown of the various taxes in Montana from the census perspective. **Mr. Finch** said they could look at doing that. He thought **Ms. Whittinghill** was referring to very specific language in the bill. It says the committee is to compile an inventory of all taxes and fees currently in place in Montana and look at those with respect to the principles of taxation and their appropriateness to comprehensive tax reform. They can start compiling the list and try to associate that list with the amount of revenue generated for the last year that data is available. **Sen. Bales** requested the amount of revenue generated and where that goes be on that list—general fund, whether it's earmarked, counties, etc. The **Department of Agriculture** and the **Department of Livestock** are run in large part on fees rather than on general revenue.

Mr. Morrison suggested they hold off on specific requests for at least one more meeting until they get some of the background information. They need to get some of that together before they start looking at specific proposals. He thought it might be helpful to get a summary of the **MACo** bill to compare to **Rep. Peterson's** and **Sen. Jeff Mangan's** bills of last session.

Mr. Watts thought they should get started on a sales tax discussion—not necessarily at the next meeting. He didn't know if it would be better to look at sales taxes that had been previously offered or the **MACo** sales tax. One alternative would be to have the **MACo** sales tax and the Peterson sales tax presented. Another way would be to appoint a subcommittee. He thought it would be hard for them as a whole group to develop a sales tax bill.

Sen. Bales advised the Senate had a subcommittee that put together SB 470. He wasn't sure they were quite ready to do that. **Rep. Peterson** offered to present the bill several of them worked on as a beginning point. In the process of making that presentation, he would share the thought process that went into it. Many of those thought processes had come out in testimony heard today, he noted. That would give the committee a beginning point to begin modifying a bill that would meet the test of good tax reform. The other option would be to compare **Sen. Mangan's** bill and HB 749 and possibly the **MACo** bill.

Sen. Perry thought they were attempting to design a product that is acceptable to the taxpayers. In order to design a product, they could spend a lot of time looking at what

other people have done, or they could design something from the ground floor up and do it right. He thought they have the expertise to advise them. He attended the **Tax Reform Symposium** at the **Burton K. Wheeler Center** and there were some diverse opinions on the panel. Some of those opinions left him feeling fairly distraught. There are diverse opinions on this committee. He would like discussion on the definition of regressivity and progressivity and what it means to each of them. He wanted to have those discussions early and try to agree on where they're heading, so in the end they can have consensus. He stressed the importance of hearing opinions from the committee.

Rep. Lake didn't think taxpayers would be done a true service without looking at all taxes and all options. This would obviously include the sales tax. Other states are having success with a flat tax income tax and he thought that should be looked at as well as the property taxing structure to make sure they aren't creating an unintended consequence by putting a taxing structure into place that will fall apart in bad times. He thought between now and the next meeting they should get beyond the single tax to find a single amount of revenue. He would like to see what revenue is currently being generated compared to what a sales tax would generate. **Mr. Finch** advised **Mr. Dodds** has an Excel model that lays all of the items that are potentially taxable under a sales tax. An item can be selected and revenue consequences can be seen immediately. **Sen. Bales** asked if that has been updated. **Mr. Dodds** replied no.

Rep. Lake said they need to be able to look at that in comparison with current revenues. **Mr. Finch** advised they can provide the committee with the current forecasts involved with the 36 general fund revenue items for the next four years. That would give a direct comparison—those revenues that are forecast under current law compared with the estimated revenues from a sales tax. **Sen. Bales** asked if that is in conjunction with all taxes and fees. **Mr. Finch** advised they have a project that is a complete inventory of all taxes and fees. It is a little broader because a lot of that doesn't apply to general fund. **Rep. Lake** didn't think the committee really wants to look at all the fees because there are fees that are earmarked directly into a department for a reason. **Sen. Bales** agreed that is true to a certain extent. When looking at the effect on businesses, those fees that may be paid or have to be paid have an effect on viability and bottom line. Part of the charge of the committee is to look at the effect on businesses.

Rep. Cohenour thought they agreed to look at the effect on taxpayers specifically. Fees need to be considered as to the effect on the individual average taxpayer. She felt the focus should be from one angle for discussions. **Sen. Bales** indicated there are single proprietor ownerships that are businesses that would be included in her definition. If they strictly look at it just from the perspective of a taxpayer or wage earner and try to do the best for them, the burden might all end up on business. The charge for the committee is to consider individuals and business. That was the legislative intent and he thought they should stick to that. **Rep. Cohenour** said she understood but the subcommittee was involved in how to get information and discuss it.

Sen. Perry asked if she was suggesting not considering taxes on business. **Rep. Cohenour** thought they were trying to focus on the discussion from the first meeting and

how to request information from the **Department of Revenue**. She stated they were getting away from what they originally said. She thought when they were requesting information they would look at it from a certain point of view. **Sen. Perry** thought they might not be that far apart.

Rep. Peterson advised they should look at the analysis they've already asked to be prepared, and a definition of regressivity and progressivity is something worth looking at. He expressed concern about going into every little tax they have with regard to fees—it is probably appropriate to look at some of it. He didn't know if they would get anything accomplished. They need a beginning point and if they don't have some consensus by late spring of next year, and without some education of the business community and the general public the opportunity of getting tax reform passed is almost nil. If the package is presented in September and taken to the legislature in January it just isn't enough time to let people know and understand what it is they are trying to do. He thought they ought to have a timetable for a consensus by mid to late spring and then there would be time for public input on their proposal and creating something that is marketable. Until a proposal is seen, it will be hard to see where people are coming from. Then they can begin to see where they have consensus.

Rep. Lake asked how many fees are used as a revenue source that isn't just about operation. **Mr. Finch** thought it was a large number. **Rep. Lake** wondered about the relationship of revenue generated to run the state.

Ms. Whittinghill advised a lot of the fees that go to the general fund are in broad categories. She thought it would be beneficial to see a snapshot. If they decide they need a sales tax, it would be good to see the total revenue collected in the state. It would be nice to know what the collections are on the revenue side, how they grow or don't grow. **Mr. Finch** said they have a ten-year snapshot already. They looked at it in broad categories. It depends on what level they want to go to. They could spend a lot of time compiling information particularly in getting information from the local government side.

Sen. Perry indicated some of the fees they are talking about are not so small that they are insubstantial. **Ms. Trenk** had stated on a \$125,000 house a \$750 fee might be a deterrent for first time homebuyers. One of the things on the table is a real estate transaction fee and that is something to discuss. The impact of the fees is affecting sales, developers and builders. There are \$12 million in these fees held up in court. That is something local governments are beginning to realize. It would be nice to know what the impact of a sales tax would be.

Sen. Bales thought for the next meeting they need to get all of the data finalized that the subcommittee has been working on. He thought it would be useful to have an inventory of taxes and fees and how they are used. He felt fees, as well as other taxes, have an impact on individuals and companies. They need to work on a timeline and he wanted to see a summation of previous committees plus what surrounding states have done or are in the process of doing. He thought they need to finalize a work plan and a timeline at the next meeting. He appointed a subcommittee to come up with a timeline: **Sen. Perry**

(Chair), Mr. Morrison, Sen. Harrington, Sen. Bales, and Mr. Jerry Driscoll. He thought at the next meeting they would review the different documents. He wondered about the offer of Rep. Peterson to present the sales tax that he proposed last session. Rep. Cohenour advised she liked what Sen. Perry was talking about. She thought the meeting after that would be more appropriate. Sen. Bales thought they should allot some time to work on the definition of regressivity and progressivity. Taxes that are considered regressive for one entity are often considered progressive for another. Any help the department could give them with that would be appreciated. He requested the spreadsheet on the sales tax be emailed.

Mr. Watts wished to have Mr. Dodds talk about the spreadsheet at the next meeting. Some of those categories are very difficult to understand. Rep. Lake indicated they could play with the information themselves if they have Excel.

Sen. Bales asked Mr. Standaert if he needed to talk to the subcommittee. Mr. Standaert said he had what he needs. He was willing to work with Mr. Finch. Mr. Finch indicated Mr. Dodds had charts and pie charts for the subcommittee.

Sen. Bales adjourned the meeting at 4:00 p.m.

Minutes read and approved by: _____
Senator Keith Bales, Chairman Date